

W&W Group

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W&W Group

Major Rating Factors

Strengths:

- A broad and diversified sales network and customer base
- Improved ERM capabilities
- Sound underwriting performance in non-life business and good loan quality in the combined banking segment
- Funding stability in the banking segment

Weaknesses:

- Continued pressure on bottom-line earnings because of low interest rates
- Limited success in achieving organic growth and effectively leveraging cross-selling opportunities
- Material exposure of the banking segment to market and credit spread risks

Counterparty Credit Rating

Local Currency
BBB-/Stable/A-3

Rationale

The ratings on the various core operating entities of the Germany-based Wuestenrot & Wuerttembergische bancassurance group (W&W) reflect Standard & Poor's Ratings Services' assessment of the group's position as a second-tier bancassurance player in Germany, with a broad and diversified sales network and customer base. Additional factors supporting the ratings are, in our view, improved enterprise risk management (ERM), sound underwriting performance in the non-life business, and good loan quality and funding stability in the banking segment.

Pressure on earnings--mainly due to ongoing low interest rates--partly offsets these strengths. The group's limited success in achieving organic growth and effectively leveraging cross-selling potential is another negative. Furthermore, the banking subgroup is exposed to substantial market risks stemming from a downward shift in the interest rate curve, and to single-name concentrations in its securities investments.

The two-notch-lower rating on the group's holding company Wuestenrot & Wuerttembergische AG (W&W AG; BBB-/Stable/A-3) acknowledges the subordination of the holding company's creditors to the senior rights of the group's primary-insurance policyholders and banking creditors, as well as W&W AG's limited access to the policyholder surplus from its life insurance subsidiary. The holding company relies predominantly on income from its regulated insurance and banking operating entities to meet its obligations.

We believe W&W benefits from its good position as a second-tier bancassurance player in the German financial services market. It has a broad and diversified sales network and customer base that has recently been further enhanced by the acquisitions of Victoria Vereinsbank Bauspar AG (VVB) and Allianz Dresdner Bauspar AG (ADB).

Enterprise risk management practices have, in our view, considerably improved over the last three years. We now consider W&W's ERM program to be adequate with a positive trend recognizing the successful implementation of a strong and group-wide consistent risk management culture as well as strong controls for the group's main risk.

We view the group's non-life underlying underwriting performance as strong, reflecting a favorable net combined

(loss and expense) ratio of 96.8% and a sound return on revenue of 11% on average from 2005-2009. We believe that a net combined ratio clearly below 100% and a return on revenue of about 10% should be sustainable over the cycle, although the ratio is likely to rise to nearly 100% in 2010 due to an increased claims frequency and pricing pressure in motor insurance. Furthermore, we view the banking segment's good loan quality as a ratings positive as the combined segment's satisfactory NPL ratio of 2.6% at end-September 2010 shows (2.9% in 2009).

Another rating strength is the banking segment's relative funding stability due to a healthy mix of core deposits and capital market issuance, making use of covered bonds.

W&W's earnings suffer increasingly, we believe, from the low interest rate environment mainly in the buildings-savings and life insurance segment. We estimate that operating net income adjusted for one-off effects from the ADB acquisition and restructuring costs dropped to about €130 million-€150 million in 2010, down from €222 million in 2009, with ROE decreasing to about 5% from 9%. Prospects for further earnings' improvements will, in our view, remain limited in the current capital market environment.

We believe that W&W is challenged to effectively leverage cross-selling opportunities between the building-savings bank and the insurance sales organization. Modest progress was reflected in a contribution of less than 10% to the overall sales of each segment in 2009. Furthermore, we are concerned that the group could face execution risks in smoothly integrating the ADB acquisition.

We have observed a material increase in the banking subgroup's market risk appetite, seen in higher VAR utilization and high sensitivities to a downward shift of the interest rate curve. Even though WBSK's and WBP's exposure to declining interest rates appears to have been re-balanced by end-2010, we are closely monitoring these positions. Furthermore, the subgroup remains exposed to credit spread risks, in particular from its €1 billion securities in Portugal, Ireland, Italy, Greece, and Spain.

Outlook

The stable outlook reflects our view of the group's limited prospects to sustainably improve its bottom line in a low-interest-rate environment. We also remain concerned about W&W's ability to effectively exploit its still-untapped cross-selling capacities. Furthermore, we believe that the group will be challenged to translate the additional sales capacities from the recent banking acquisitions into meaningful, sustainable, and profitable organic growth.

For 2011 and 2012 we anticipate the group's net income will stabilize between €100 million-€150 million resulting in a moderate ROE of 4%-5%, and we expect the group's capital adequacy to remain at least good. For the banking subgroup we expect that the RAC ratio will remain above 8.5% by 2012. For the non-life insurance segment we expect a net combined ratio of between 97%-100% and a return on revenue of close to 10%. For the life insurance segment we project new business, as measured by the annual premium equivalent (APE), to remain stable in 2011 and 2012, delivering a new-business margin of about 10% of APE. In addition, we expect the operating return on embedded value to exceed 10%.

We may consider a positive rating action over the next 12 to 24 months if the group were to demonstrate notable progress in achieving and sustaining net earnings after tax of €250 million through profitable organic growth, mainly in the banking segment.

Conversely, we could lower the ratings if the group's operating performance and capitalization were to significantly deteriorate to a level materially lower than our expectations.

Profile: A Second-Tier Bancassurance Player In Germany

W&W is a second-tier player in the German financial services retail market and is involved in building-savings activity, retail banking, life and non-life insurance, and asset management. W&W's core operating insurance entities are Wuerttembergische Lebensversicherung AG (WL; life) and Wuerttembergische Versicherung AG (WV; non-life). The group's core banking entities are Wuestenrot Bausparkasse AG (WBSK), a building-savings (bauspar) bank, and Wuestenrot Bank AG Pfandbriefbank (WBP), a residential mortgage provider with some retail deposit and asset-management business and a covered bonds issuer (Pfandbriefe). The group expanded its activities in buildings-savings through acquiring VVB in 2009 and ADB in 2010 and the subsequent merger into WBSK.

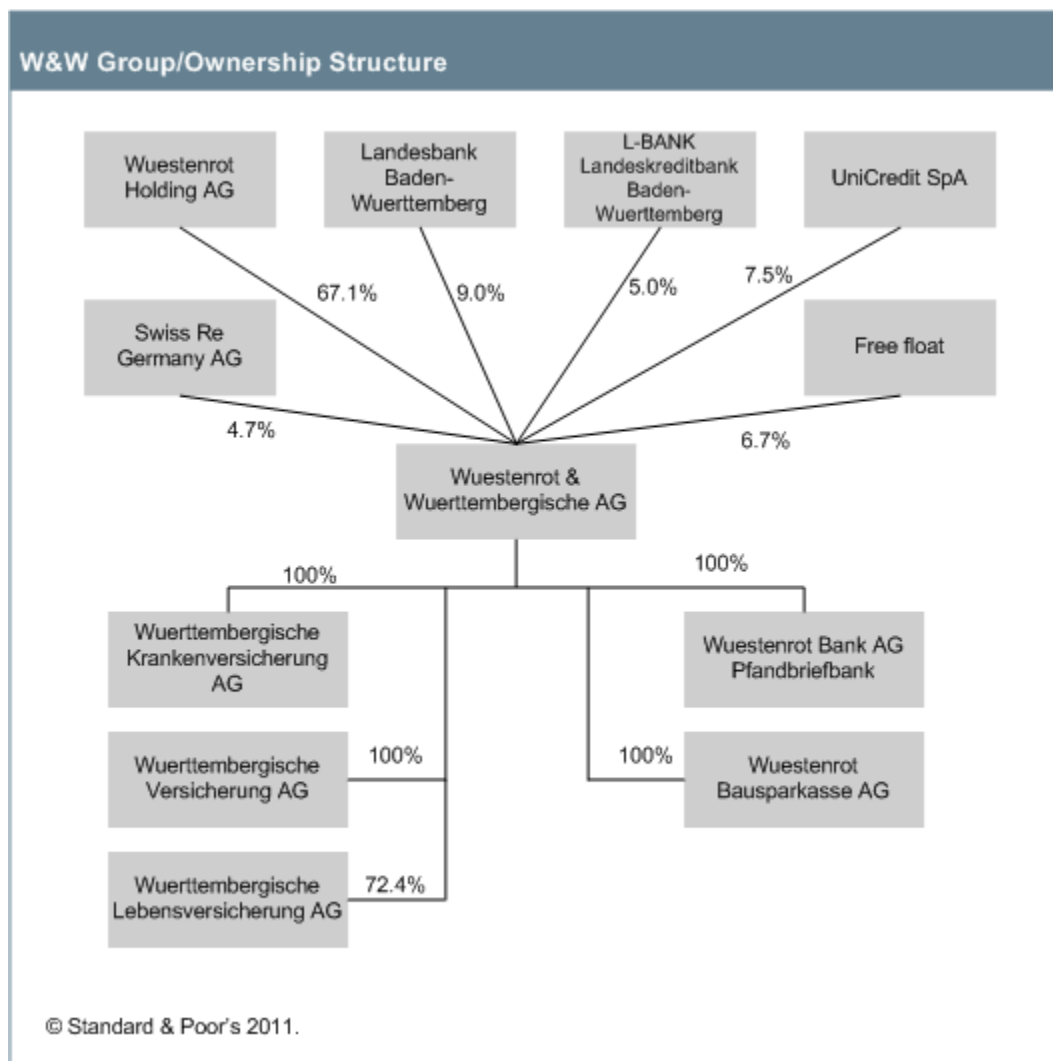
At end-September 2010, the group had €76.7 billion (€69.5 billion in 2009) in consolidated assets. Its two core segments, banking and insurance, each contributed about 50% of the group's consolidated assets (see table 1).

Table 1

W&W Group/Segment Reporting (as per IFRS)															
(Mil. €)	--Revenues*--			--Income before tax--			--Assets--			--Capital--			--Average staff--		
	9M10	2009	2008	9M10	2009	2008	9M10†	2009	2008	9M10†	2009	2008	9M10	2009	2008
Building-savings segment	323	475	382	98	153	31	40,421	34,443	30,373	1,568	1,322	1,264	1,882	1,856	2,098
Life insurance	2,821	3,522	2,504	22	6	19	30,871	29,972	29,197	186	171	114	805	814	898
Non-life insurance	868	1,106	1,131	39	119	33	3,730	3,729	3,765	524	501	390	3,588	3,772	3,887
Other/consolidation	145	236	167	7	14	19	1,630	1,396	1,113	670	654	570	2,128	1,758	1,433
Total W&W group	4,157	5,339	4,184	167	292	100	76,653	69,539	64,448	2,948	2,647	2,338	8,403	8,200	8,316

*Revenues for building-savings segment include: reported net financial result gross of the building-savings segment's loan loss provisions; Revenues of the insurance segments include: net financial result + net income/expenses from investment property + net premiums earned. †Estimates for segments.

W&W's entities are joint-stock companies, owned by W&W AG, the group's holding company (see chart). W&W AG has profit-and-loss transfer agreements with WBP and WV.



Competitive Position: Growth Potential For Banking, But Limited Prospects For Insurance

Table 2

W&W Insurance Group/Competitive Position*					
--Year ended Dec. 31--					
(Mil. €)	2009	2008	2007	2006	2005
Wuerttembergische Versicherung AG					
Gross premiums written	1,305	1,287	1,474	1,611	1,371
Annual change (%)	1.4	(12.7)	(8.5)	17.5	(0.3)
Net premiums written	1,061	1,042	1,163	1,225	1,019
Gross premiums written by line of business (%)					
Accident and health/other	9.7	9.9	8.6	7.9	7.3
Motor	38.5	38.6	35.4	34.6	35.6

Table 2

W&W Insurance Group/Competitive Position* (cont.)					
Marine, aviation, and transport	0.9	0.9	1.6	1.8	2.2
Property	30	29.4	26.3	24.3	25.6
Liability	13.4	13.6	13.9	13.4	13.4
Pecuniary	7.2	7.3	6.3	5.6	5.3
Other	0.2	0.3	8	12.4	10.6
Württembergische Lebensversicherung AG					
Total gross premiums written	2,183	2,096	2,168	2,245	1,327
Annual change (%)	4.1	(3.3)	(3.4)	69.1	6.6
Total net premiums written	2,071	1,971	2,037	2,093	1,303
Annual change (%)	5	(3.2)	(2.7)	60.7	9

*Since 2006 including the Karlsruher insurance group.

Group

We regard W&W's overall competitive position as good, and its management and corporate strategy as supportive of the rating. Overall, the group's strategy and risk appetite are, in our view, mostly aligned with the available resources. We also note W&W's complexity relative to its size and potentially limited capacities as the group is going through various restructurings. After completion of the W&W 2009 program, management started a further major efficiency improvement program named W&W 2012. The main goals of this program are sustainable above-market-average growth and competitive cost and service levels via new information technology to sustain a net income of about €250 million by 2012. High implementation costs of €283 million will, however, cause short-to medium-term bottom-line pressures and we believe that execution risk will absorb much management attention and manpower capacities.

With about 6,000 self-employed exclusive agents and a customer base of about six million (banking segment, 54%; insurance, 46%), W&W should be in a good position to increase its cross-selling activity. However, with a continuously modest contribution of less than 10% to new business volumes the cross-selling potential between the banking and insurance segments has remained largely untapped.

We recognize that the recent acquisitions of the VVB and ADB building-savings operations have increased the group's market share and offer further new-business-growth potential. Nevertheless, we believe the integration process causes execution risks in addition to those already arising from the implementation of the program W&W 2012.

Insurance

W&W's insurance arm was among the top 10 players in the German life and non-life insurance industry in 2009.

The life segment focuses on traditional endowment and term policies, annuities, and, increasingly, innovative products combining unit-linked and guarantee features. New life insurance business--as measured by APE--was relatively stable in 2009 and largely in line with the market. Premium growth of about 4.5% in 2010 is, in our opinion, mainly driven by the market-wide significant increase in single-premium business, which has compensated for a further decline in regular-premium business. For 2011, however, we forecast sales and premium income to remain relatively stable because the sustainability of the single-premium business boom is uncertain, in our view, and the prospects for additional regular-premium business in the German market are limited. Moreover, we expect management to focus on selective underwriting of less-interest-rate-sensitive protection and unit-linked insurance

products.

The non-life segment caters for individuals and small and midsize enterprises. Gross premiums written (GPW) increased above market average by about 1.4% in 2009 mainly driven by business with corporate clients. GPW growth of about 2% in 2010 was, in our view, to some extent driven by the competitive motor business. Nevertheless, we believe that W&W will adhere to a profit-oriented underwriting policy that should result in relatively flat premium development in 2011 and 2012.

Banking

The group restored its market position in the German building-savings business via the acquisitions of VVB in 2009 and ADB in April 2010 (see chart 2). WBSK's net new business volume of €11.4 billion in 2010 (36% increase compared to end-2009) resulted in a share of the German bauspar market of about 12% at end-2010. We would expect that WBSK and ultimately W&W further benefit from the new distribution agreements with Commerzbank AG, Allianz SE, UniCredit Bank AG (formerly Bayerische Hypo- und Vereinsbank AG), and ERGO Versicherungsgruppe AG. At end-2010, new buildings-savings contract volumes from this distribution channel increased to 31% (see table 3).

Chart 2

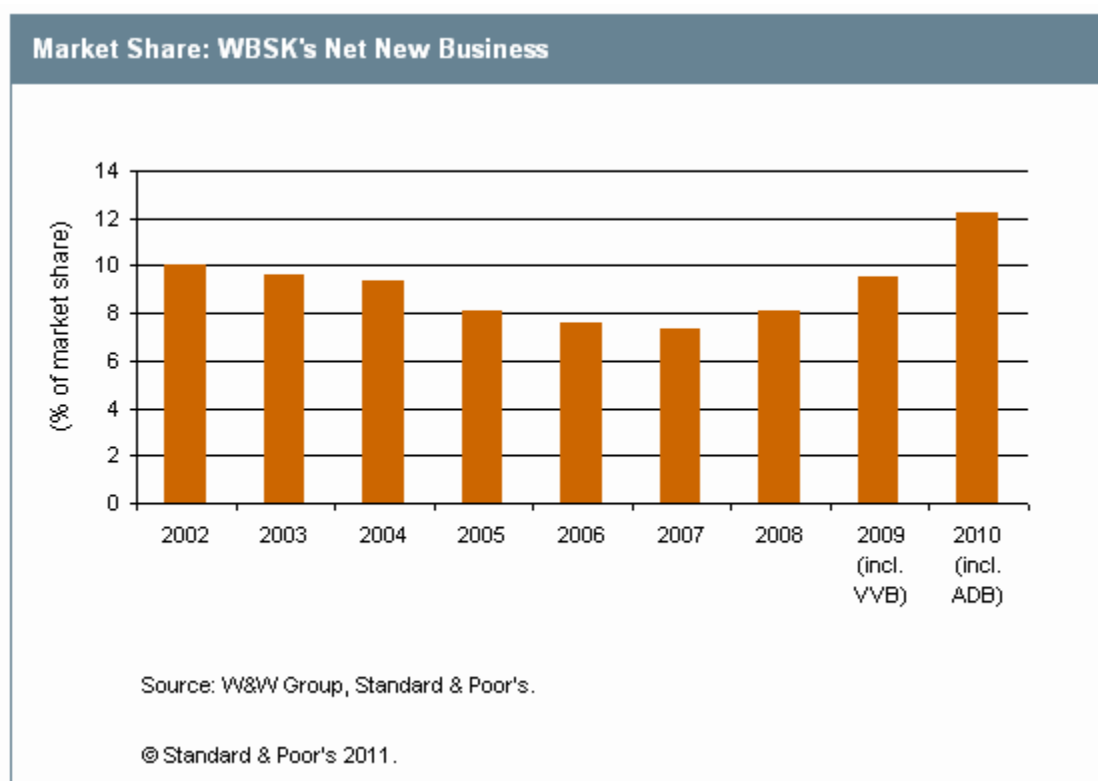


Table 3

Net New Bauspar Contract Business Volumes Per Distribution Channel		
%	2009	2010
W&W's Banking Distribution Network	73.4	57.3
W&W's Insurance Distribution Network	6.9	6.1

Table 3

Net New Bauspar Contract Business Volumes Per Distribution Channel (cont.)		
Banks*	10.9	31.2
Other	8.9	5.4
Total	100	100

*HVB/ERGO, Commerzbank, Allianz/OLB. Source: W&W Group.

In 2010 the W&W group's market share in new residential mortgage lending improved slightly to 3.0% (2009: 2.6%). Although WBP's expansion into standard retail banking shows encouraging progress, the related impact on profitability remains relatively small.

Enterprise Risk Management: Improved to Adequate With Positive Trend

We now consider the group's ERM, which has markedly improved over the past three years, to be adequate with a positive trend and we expect that it could become strong in the coming 24 months. We do not expect the group to experience losses outside of the normal range from traditional risk areas. We view as strong the risk-management culture and controls for the group's main risks, which are asset-liability management, market, and credit risks. Strong risk controls are, in our view, also in place for non-life underwriting including natural catastrophes as well as for new product risks after a new systematic process has been implemented. We assess as adequate the group's reserving, reinsurance, and operational risk controls, as well as its emerging risk management.

The group has implemented a strong and consistent risk management culture and governance across all insurance and banking segments and business units. This includes a consistent group risk appetite framework including risk tolerance levels and operational limit systems. The risk appetite is determined by the group's executive board, taking into account statutory as well as economic capital requirements and available financial resources.

We believe the group has enhanced its strategic risk management capabilities by integrating risk and return targets into its value-based management approach, including performance measurement and remuneration systems for management and the sales organization. The group, however, has yet to deliver a more sustained track record of effective execution of this.

Although W&W offers mainly retail products in only one geographical market, ERM is an important rating factor because of the complexity inherent in the business model to operate both, the building-savings and insurance business.

Investment Management And Risk Profile: Asset Quality Is High, But Concentrated In Germany

In our view, W&W's asset quality benefits from highly rated investments and granular, secured retail loans. Lending is concentrated in Germany, however, the values of German residential properties are less inflated than in other countries. Market risk remains a key issue because both the building-savings business and the life insurance operations are highly sensitive to interest rate movements.

The group has not applied for funding support under the German government's financial institutions rescue package in 2009/2010. The liquidity of the insurance operations' large investments is high, and the group monitors its

investments daily, particularly to determine the level of cash needed to settle claims.

Insurance

High credit quality of the investment portfolio

The insurance entities' investment portfolios consist predominantly of fixed-income securities (about 76%), mainly registered bonds of which about 80% were rated at least 'AA' at year-end 2009. Only 3% were speculative grade or not rated. About 8% of W&W's investments is in government bonds, which have a limited concentration in Italy, Germany, and France.

Market/ALM risk – Manageable within risk tolerances

Potential market risks from equities are, in our view, manageable for the insurance operations. According to the strategic asset allocation for 2010, equity exposure has been limited to about 3% of total investments for life and 5% for non-life. Equity risk is also still largely protected by derivatives. We consider asset-liability-management (ALM)-risks relating to interest rate fluctuations as the main risks for the group's insurance operations. W&W uses stochastic models that apply Monte Carlo simulations to assess ALM risks and monitors the interaction between reinvestment yield, net investment return, and guaranteed interest rates through scenario analyses and stress tests. Risks from ALM mismatches in life insurance have been mitigated by reducing the duration gap between assets and liabilities to a lower-than-market-average of 4.0 years during 2010. To address falling investment returns, the group has lowered its bonus rate for 2010 to 3.9% from 4.1%, which we view as positive for stabilizing the financial strength.

Banking

Credit risk: Credit quality should remain sound

We expect the banking subgroup's asset quality to remain sound as we consider the loan portfolio relatively robust due to its granularity, diversity, and a high level of homeowner financing.

The banking subgroup's low credit costs (annualized 15 basis points on average gross loans at September 2010) may be challenging to sustain. We would expect credit costs to rise to around 25 bps normalized (see Operating Performance), also considering W&W's revision of its provisioning policies to meet regulatory requirements. Nevertheless, the relative stability of the German property market, good underwriting standards, and more-stringent risk-adjusted pricing should provide a buffer against loan deterioration if unemployment were to rise significantly.

Nonperforming loans (for which the bank booked a provision) were 2.6% of the subgroup's gross customer loans at end-September 2010 (2009: 2.9%). They were 32% covered by loan loss reserves (2009: 30%), which is rather low. However, we believe this is somewhat mitigated by WBSK's and WBP's small share of uncollateralized loans (2009: 4%) and low portion of loans backed by residential property with LTVs above 80% (2009: 5%). The majority (60%) of loans are backed by collateral marked at LTVs below 60% and 31% of loans at LTVs of 61%-80%

While we would consider loan losses manageable, we are more concerned about concentration risk in WBP's and WBSK's securities portfolio, which increased significantly to €11 billion or 27% of segment-assets at end-September 2010 (2008: €5 billion or 16%). While those assets are of high quality, the banking segment is exposed to single-name concentrations. The 20 largest securities holdings amounted to 30% of the available-for-sale securities portfolio at end-November 2010 (see table 4). Exposures to Spain, Italy, Portugal, Greece, and Ireland were €1 billion (see table 5).

Table 4

Banking Segments Available for Sale Securities at end-November 2010		
	Notional (% of total)	Notional (€ mil.)
WBP	51	4,956
WBSK	49	4,746
Total	100	9,702
Top 10 Banking Segment / Total	39	3,771
Top 20 Banking Segment / Total	27	2,635

Source: W&W Group.

Table 5

Notional Exposures To Portugal, Italy, Ireland, Greece, Spain		
At End-November, 2010		
€ mil.	Total	Thereof sovereigns
Portugal	55	25
Italy	444	245
Ireland	25	0
Greece	150	150
Spain	315	0
Banking Segment Total	989	420
WBP	889	320
WBSK	100	100

Source: W&W Group.

Funding and liquidity risk: Mitigated by good retail access

Funding benefits from a substantial volume of granular retail deposits, mainly sourced from WBSK, but increasingly from WBP, although we would not consider WBP's newly gathered deposits as core deposits due to their volatile nature. The segment's customer loans/customer deposit ratio stood at a comfortable 91% at end-September 2010 (2009: 97%). Including advances to and deposits from financial institutions, the loans/deposit ratio improves to 82% (85%). That said, single-name dependencies are a risk in the banking segment's wholesale deposits: the 20 largest financial-institution counterparties comprised about 30% of that funding source at end-2009.

Market risk: Plays a structurally pivotal role

The key challenge in the building-savings bank's business model is managing the ratio of scheme borrowers to depositors. Owing to the protracted low-interest-rate environment and a reasonably flat yield curve, a sizeable proportion of building savings (bauspar) contracts have become unfavorable for WBSK and require additional reserving. With pre-agreed lending rates being no longer competitive, customers chose to refrain from taking out loans and in turn may even benefit from a higher deposit rewards. W&W aims to adjust its tariffs but we expect that this will only slowly improve the bauspar scheme's borrowers-to-depositors ratio, which has been declining steadily to 23.6% at end-September 2010.

Furthermore, the banking segment is exposed to interest-rate and credit-spread risks from its securities holdings. We understand that market risks, with the exception of credit-spread risks, are largely hedged. That said, a downward shift of the interest rate curve by 190bps (in line with the regulatory stress test) would have seen material mark-to-market losses of 10%-20% of WBSK's (and to a lesser extent also WBP's) individual equity throughout

2010.

The value-at-risk for WBSK peaked in August 2010. With a 0.1% probability, WBSK could have lost more than 48% of its total adjusted capital (TAC) over a one year horizon (99.9% VAR, 250-day holding period, 1500-day history). This compares to an average 25% potential annual loss of TAC in January 2009-October 2010. WBP's VAR (99%, 10 days, 150 days) remained relatively stable at around 2% of its TAC in 2009-2010.

Accounting: Disclosure Of Consolidated Accounts Under IFRS

W&W discloses consolidated financial statements under IFRS. Additionally, all group entities report under German generally accepted accounting principles (GAAP). We have based our consolidated group analysis mainly on IFRS figures, but used the German GAAP figures to supplement our evaluation of the individual segments. Our assessment of the life insurance performance is based on market-consistent embedded value (MCEV) metrics, which the group, however, has not yet publicly disclosed.

We assessed the capitalization of the combined banking and insurance group based on consolidated capital requirements according to our risk based models and the consolidated IFRS shareholders' equity, which we adjusted for the specific insurance and banking components as follows:

- Crediting 50% of non-life reserve redundancies and 67% of the non-life loss reserve discount not included in the balance sheet;
- Crediting 50% of the life insurance value-in-force not included in the balance sheet;
- Adding the free and unallocated portion of the policyholder bonus reserve in life insurance; and
- WBSK's "Bauspartechnischer Fond", a reserve fund aimed to protect the savings/loan collective, which is part of IFRS equity. As WBSK does not have full discretion over these funds (€296 million at end-2009), we deduct them from equity. Therefore, the TAC for the segment was €1.2 billion at end-September 2010; WBSK: €1 billion, WBP: €0.2 billion (2009: €1.2 billion).

Operating Performance: Good, But Affected By Continued Low Interest Rate Environment

Table 6

W&W Insurance Group/Operating Statistics*					
(Mil. €)	--Year-ended Dec. 31--				
	2009	2008	2007	2006	2005
Wuerttembergische Versicherung AG					
Total revenue	1,148	1,240	1,284	1,296	1,095
Net income¶	136.6	(0.7)	32.4	66.6	67.2
Net loss ratio (%)	63.5	71.9	68.1	67.9	68.1
Net expense ratio (%)	28.6	29.2	29.1	28.8	28.7
Net combined ratio (%)	92.1	101.1	97.2	96.7	96.8
Portfolio performance					
Net investment income (excl.unrealized and realized items)	82	147	105	94	75
Direct yield on invested assets (%)	3.3	5.8	4.1	3.9	3.5

Table 6

W&W Insurance Group/Operating Statistics* (cont.)					
Yield (including realized) (%)	3.5	6.3	3.6	4.2	4.7
Total investment return (including unrealized and realized) (%)	3.4	1.4	2.9	3.7	4.4
Wuerttembergische Lebensversicherung AG					
Reported net income	15	12	20	34	12
Unsmoothed pretax before bonus return on assets (basis points)	107	108	204	301	252
Administrative expense (GDV)	2.9	3.1	3.2	3.3	3.2
Acquisition expense (GDV)	6.8	6.4	6.4	6.5	6.7
Portfolio performance					
Net investment income (excl.unrealized and realized items)	990	1,270	1,287	1,160	538
Direct yield on invested assets (%)	3.9	5	5	5.9	3.9
Yield (including realized) (%)	4.4	6.3	5.4	6.8	4.5
Total investment return (including unrealized and realized) (%)	3.7	3.3	4.8	6.3	4.9

*Since 2006 including the Karlsruhe insurance group. †Adjusted for equalization reserve. GDV--According to the German Insurance Association guidelines.

Group

The group's overall operating performance is good, in our view. In 2009 W&W's after-tax net income increased significantly to €222 million from €67 million in 2008, boosting the ROE to 9.1% mainly benefiting from invested securities and treasury operations in the banking segment and a strong technical performance in non-life business. However, we anticipate continued pressure on earnings mainly in buildings-savings and life insurance, resulting from low interest rates and from somewhat higher risk costs in the banking segment. Adjusted for one-off effects resulting from the 2012 strategic program and the ADB acquisition we estimate the group's 2010 net income to have decreased to about €130 million-€150 million, resulting in a reduced ROE of about 5%. Given ongoing low interest rates in 2011 and 2012 we anticipate net income and ROE to stabilize between €100-€150 million and 4%-5% respectively.

Insurance

We view the operating performance of the insurance operations as strong. They are likely to contribute about 50% of the group's net income after adjustments for one-off impacts in 2010. The group's non-life underwriting performance is strong in our view. The net combined ratio and the return on revenue were favorable at 96.8% and 11% on average between 2005 and 2009. We believe that a net combined ratio of between 97% and 100% and a return on revenue of about 10% should be sustainable over the cycle, although the 2010 ratio will likely approach 100% due to increased claims frequencies and pricing pressure in motor business.

The group's life performance based on market-consistent embedded value metrics has improved in recent years, reflected in a new-business margin of about 10% of the annual premium equivalent (APE) in 2009 and 2008, after 8.5% in 2007 and 6.2% in 2006. We believe that it may take some time for the new product and sales strategy--which focuses on protection and innovative, less interest-rate-sensitive life insurance products--to materially improve the new business margin. So, for 2011 and 2012 we expect this margin to remain at the current level of about 10% of APE. Furthermore, we anticipate the operating return on embedded value to exceed 10%.

We also expect the life business's bottom line profitability based on German GAAP and IFRS accounts to remain under pressure in the currently low interest rate environment. The portfolio is still dominated by traditional products with an average guaranteed interest rate of 3.5%. WL's acquisition expense ratio is above the market

average of 5.2% and increased even further to 6.8% in 2009 from 6.4% in 2008 mainly due to the launch of new products. The administrative expense ratio decreased to 2.9%, however, and has come closer to the market average of 2.7%. The lapse ratio of 5.7% in 2009 remained below the market average (6.2%) although it increased considerably from 4.8% in 2008 in the wake of the global economic crisis.

Banking

Adjusted for €80 million non-recurring items related to the ADB acquisition (€98 million acquisition gain, €18 million restructuring and integration costs), profit using IFRS plummeted to €17 million (2009: €136 million) year-to-date September 2010. Interest expenses increased markedly due to a charge for higher future bonus payments, which WBSK estimates it has to pay to its clients as they refrain from taking out uncompetitive baspar loans. WBSK also decreased the applied discount rate to these future estimated payments. The charges stem largely from the newly acquired businesses--ADB (€20 million) and VVB (€14 million) but a portion still relates to WBSK's legacy tariff schemes (€18 million). Other factors include lower interest income on securities and loans to financial institutions with variable coupons, decreasing average net interest spreads on outstanding baspar loans, and higher volumes of relatively costly deposits from ADB/VVB.

We believe that WBSK's and WBP's combined earnings are able to withstand mild stresses. Under the following assumptions, we project that the segment can generate average recurring annual pre-tax profit of about €18 million for 2011-2013 (2011 pre-tax profit before extraordinary items/RoE: -€22m/-2%, 2012: €25m/2%, 2013: €50m/4%):

- CAGR of gross customer loans of 3%, 2011-2013 (budgeted 7%), CAGR of gross loans of 4%, 2011-2013 (budgeted 8%).
- Average net interest margin of 100 bps per year on adjusted average gross loans (end-September 2010: 84 bps annualized, 2009: 109 bps). We include income from advances minus expenses on liabilities for the purposes of this calculation.
- 15% per year lower than budgeted non-interest income on securities.
- Normalized credit costs at 25 bps per year on adjusted customer loans (end-September: 15 bps annualized, 2009: 16 bps)

We conclude from this scenario analysis that the banking segment's ability to strengthen capital through earnings generation is moderate. In our view, revenue generation remains a relative rating weakness.

At end-September 2010, the banking segment's costs were a very high 86% of revenues. Under our projections, the cost/income ratio should somewhat decline to about 78% in 2013 driven by modest revenue growth and declining costs as budgeted by the bank. The operational integration of VVB, which was technically finalized in 2010, may continue to bind resources and as such delay the realization of synergy potential from the ADB transaction until the medium term.

Interest income from loans and securities will continue to dominate the banking segment's profitability using IFRS, with fair value income from derivatives and changes in the revaluation reserve (€191 million at September 2010) as offsetting positions. As such, the segment's profitability using IFRS will remain volatile (particularly due to imperfect hedging relationships using IFRS) and we understand that the group intends to stabilize the P&L via various initiatives.

Capitalization: At A Strong Level

Table 7

W&W Insurance Group/Financial Statistics*					
	--Year ended Dec. 31--				
(Mil. €)	2009	2008	2007	2006	2005
Wuerttembergische Versicherung AG					
Total assets	2,687	2,706	2,847	2,821	2,440
Total reported equity	207	207	207	186	207
Reinsurance utilization ratio (%)	18.7	19	21.1	24	25.7
Technical reserves/net premiums written (%)	164.1	175.4	160.6	150.8	154.8
Wuerttembergische Lebensversicherung AG					
Total assets	26,707	26,457	26,863	26,406	13,818
Total reported equity	165	162	170	165	162

*Since 2006 including the Karlsruher insurance group.

Group

W&W's overall capitalization is strong, in our view, thanks to solid shareholders' funds and sound life policyholder bonus reserves. The statutory group solvency position for the financial conglomerates was also well above requirements.

Insurance

We expect the insurance sub-group to maintain its overall strong capitalization, benefiting from the extremely strong capital adequacy of the non-life operation according to our model. Non-life capital requirements for liability risks are moderate due to prudent underwriting and reinsurance policies. Non-life loss reserves are also conservative, in our view, with statutory net loss reserves at 153% of NPW in 2009. Capitalization of the life operation, however, is less comfortable although still good in our view. Our assessment takes into account good capital adequacy, according to our model, and moderate quality of capital dominated by policyholder bonus reserves.

Banking

We regard the aggregate capital strength of the group's banking segment as adequate. Based on our risk adjusted capital (RAC) framework, we estimate the segment's RAC ratio at 9.8% at end-2009 (before and after diversification, based on TAC as per IFRS). This estimation includes an RWA adjustment for ADB. According to our projections, the banking segment would maintain a RAC ratio above 8.5% by end-2012, considering 4% annual RWA growth and earnings retention as per our scenario assumptions. According to our methodology, an 8% RAC ratio implies that a bank in a developed country has sufficient capital to withstand a substantial stress scenario.

The group's internal capital planning indicates that management aims to balance future RWA growth with lower risk weights under the regulatory IRB approach, which the banking entities plan to implement by 2013. As these lower risk weights are partly already applied in our RAC framework, our ratio starts from a higher level but still reflects this declining trend.

We note that WBSK's potential bonus payments, even under its most unfavorable tariff schemes, are not fully covered by reserves. We estimate that the overall shortfall (including VVB's and ADB's portfolios) was about €300

million or 25% of the banking segment's unadjusted TAC (IFRS) at end-September 2010.

Financial Flexibility: Limited Capital Needs

We view W&W's financial flexibility (defined as a company's ability to source capital relative to its needs) as strong. Since access to capital markets appears limited in the current environment, we expect retained earnings to be the main source of equity funding. However, we don't anticipate the need for material external funding because we don't expect W&W group to undertake larger acquisitions any time soon. Future capital needs would likely stem mainly from organic growth and from smaller bolt-on acquisitions in the insurance segment.

Table 8

Wuestenrot Bausparkasse AG (German GAAP / HGB)				
Balance sheet date year	--fiscal year-end Dec. 31--			
	2009	2008	2007	2006
€ mil.				
Profitability Ratios				
Net interest income/average earning assets	2.14	1.49	1.70	1.54
Net interest income/revenues	82.34	80.85	75.04	90.71
Fee income/revenues	(3.46)	(8.50)	(0.71)	(0.73)
Market-sensitive income/revenues	-	-	-	-
Personnel expense/revenues	31.16	46.35	41.81	57.45
Noninterest expenses/revenues	77.91	100.28	84.10	89.65
New loan loss provisions/revenues	3.61	11.96	11.63	19.66
Net operating income before loan loss provisions/loan loss provisions	611.72	(2.30)	136.72	52.64
Net operating income after loan loss provisions/revenues	18.48	(12.23)	4.27	(9.31)
Pretax profit/revenues	18.48	5.13	4.27	(28.71)
Tax/pretax profit	17.22	14.61	18.36	16.40
Core earnings/revenues	15.30	(10.45)	3.49	N/A
Core earnings/average adjusted assets	0.40	(0.19)	0.08	N/A
Noninterest expenses/average adjusted assets	2.01	1.84	1.90	1.52
Core earnings/average adjusted common equity	9.93	(4.89)	2.16	N/A
Pretax profit/average common equity (%)	12.00	2.40	2.65	(12.53)
Capital Ratios				
Tier 1 capital ratio	10.20	11.50	N/A	N/A
Adjusted total equity/adjusted assets	3.94	4.03	3.80	3.48
Adjusted total equity plus loan loss reserves (specific)/customer loans (gross)	5.92	6.07	5.82	5.33
Summary Balance Sheet				
Assets				
Cash and money market instruments	49	24	30	41
Securities	3,520	2,675	2,055	1,262
Nontrading securities	3,520	2,675	2,055	1,262
Loans to banks (net)	2,591	2,887	4,024	5,181
Customer loans (gross)	12,380	11,156	11,629	12,423
Customer loans (net)	12,380	11,156	11,629	12,423

Table 8

Wuestenrot Bausparkasse AG (German GAAP / HGB) (cont.)				
Earning assets	18,537	16,736	17,735	18,905
Equity interests/participations (nonfinancial)	2	0	0	0
Fixed assets	5	7	8	10
Accrued receivables	7	2	2	1
All other assets	36	50	47	115
Total assets	18,591	16,800	17,795	19,035
Adjusted assets	18,591	16,800	17,795	19,035
Liabilities				
Total deposits	16,523	15,252	16,203	17,403
Noncore deposits	2,080	2,718	2,292	2,667
Core/customer deposits	14,443	12,534	13,911	14,736
Other borrowings	10	0	28	48
Other liabilities	1,325	872	887	921
Total liabilities	17,858	16,124	17,118	18,372
Total equity	733	677	677	662
Common shareholders' equity (reported)	733	677	677	662
Share capital and surplus	171	171	171	171
Retained profits	70	14	14	0
Total liabilities and equity	18,591	16,800	17,795	19,035
Profit And Loss				
Net interest income	377	256	312	295
Interest income	834	824	843	895
Interest expense	457	567	532	599
Operating noninterest income	81	61	104	30
Fees and commissions	(16)	(27)	(3)	(2)
Trading gains	0	0	0	0
Equity in earnings of unconsolidated subsidiaries	8	0	0	0
Other noninterest income	89	88	107	33
Operating revenues	458	317	415	326
Noninterest expenses	357	318	349	292
Personnel expenses	143	147	174	187
Other general and administrative expense	212	169	172	95
Preprovision operating income	101	(1)	66	34
Credit loss provisions (net new)	17	38	48	64
Operating income after loss provisions	85	(39)	18	(30)
Nonrecurring/special income	-	55	-	-
Nonrecurring/special expense	-	-	-	86
Pretax profit	85	16	18	(93)
Tax expense/credit	15	2	3	(15)
Net income before extraordinaries	70	14	14	(78)
Net income after extraordinaries	70	14	14	(78)

N/A--Not applicable.

Table 9

Wuestenrot Bank AG Pfandbriefbank (German GAAP / HGB)				
	--fiscal year-end Dec. 31--			
Balance sheet date year	2009	2008	2007	2006
€ mil.				
Profitability Ratios				
Net interest income/average earning assets	0.77	0.83	0.71	0.82
Net interest income/revenues	92.83	94.68	88.42	99.36
Fee income/revenues	(4.85)	(6.23)	(0.67)	(8.20)
Market-sensitive income/revenues	3.34	(0.52)	2.05	2.69
Personnel expense/revenues	15.91	18.97	21.02	22.82
Noninterest expenses/revenues	71.87	76.55	80.58	82.30
New loan loss provisions/revenues	12.17	22.22	19.06	46.26
Net operating income before loan loss provisions/loan loss provisions	231.03	105.56	101.88	38.26
Net operating income after loan loss provisions/revenues	15.95	1.23	0.36	(28.56)
Pretax profit/revenues	15.95	1.23	0.36	(37.23)
Core earnings/revenues	15.20	7.39	0.51	(28.58)
Core earnings/average adjusted assets	0.13	0.06	-	(0.23)
Noninterest expenses/average adjusted assets	0.59	0.67	0.64	0.67
Core earnings/average adjusted common equity	5.35	2.65	0.17	(10.59)
Pretax profit/average common equity (%)	5.61	0.44	0.12	(13.66)
Capital Ratios				
Tier 1 capital ratio	6.00	5.60	5.05	5.15
Adjusted total equity/adjusted assets	2.19	2.53	2.34	2.32
Adjusted total equity plus loan loss reserves (specific)/customer loans (gross)	3.51	3.31	2.98	2.76
Summary Balance Sheet				
Assets				
Cash and money market instruments	494	355	344	227
Securities	5,114	2,139	1,352	1,224
Nontrading securities	5,114	2,139	1,352	1,224
Loans to banks (net)	121	640	1,354	780
Customer loans (net)	9,555	10,139	11,256	12,137
Earning assets	15,193	13,179	14,173	14,280
Investments in unconsolidated subsidiaries (financial companies)	0	0	0	1
Accrued receivables	4	5	7	10
All other assets	12	11	39	79
Total assets	15,302	13,289	14,351	14,458
Adjusted assets	15,301	13,289	14,351	14,458
Liabilities				
Total deposits	10,236	7,359	7,509	7,352
Noncore deposits	4,508	2,492	3,157	3,092
Core/customer deposits	5,727	4,867	4,352	4,260
Other borrowings	397	431	1,062	1,383
Other other borrowings	75	80	112	127

Table 9

Wuestenrot Bank AG Pfandbriefbank (German GAAP / HGB) (cont.)				
Other liabilities	87	87	41	110
Total liabilities	14,966	12,953	14,015	14,122
Total equity	336	336	336	336
Common shareholders' equity (reported)	336	336	336	336
Share capital and surplus	100	100	100	100
Total liabilities and equity	15,302	13,289	14,351	14,458
Profit And Loss				
Net interest income	110	114	101	122
Interest income	605	687	702	712
Interest expense	496	573	601	589
Operating noninterest income	8	6	13	1
Fees and commissions	(6)	(8)	(1)	(10)
Trading gains	8	(1)	2	3
Other noninterest income	10	15	12	7
Operating revenues	118	120	114	123
Noninterest expenses	85	92	92	101
Personnel expenses	19	23	24	28
Other general and administrative expense	66	69	68	67
Preprovision operating income	33	28	22	22
Credit loss provisions (net new)	14	27	22	57
Operating income after loss provisions	19	1	-	(35)
Nonrecurring/special expense	-	-	-	11
Pretax profit	19	1	-	(46)
Tax expense/credit	1	(7)	-	-
Net income before extraordinaries	18	9	1	(46)
Net income after extraordinaries	-	-	-	-

Ratings Detail (As Of March 3, 2011)***Wuestenrot & Wuerttembergische AG**

Financial Strength Rating

Local Currency

BBB-/Stable/--

Counterparty Credit Rating

Local Currency

BBB-/Stable/A-3

Counterparty Credit Ratings History

20-Dec-2006

Local Currency

BBB-/Stable/A-3

24-Nov-2006

BBB/Watch Neg/A-3

20-Dec-2005

BBB/Stable/A-3

Related Entities**Wuerttembergische Lebensversicherung AG**

Financial Strength Rating

Local Currency

BBB+/Stable/--

Issuer Credit Rating

Local Currency

BBB+/Stable/--

Ratings Detail (As Of March 3, 2011)* (cont.)

Subordinated (1 Issue)	BBB-
Württembergische Versicherung AG	
Financial Strength Rating	
<i>Local Currency</i>	BBB+/Stable/--
Issuer Credit Rating	
<i>Local Currency</i>	BBB+/Stable/--
Subordinated (1 Issue)	BBB-
Wuestenrot Bank AG Pfandbriefbank	
Issuer Credit Rating	BBB+/Stable/A-2
Certificate Of Deposit	BBB+/A-2
Wuestenrot Bausparkasse AG	
Issuer Credit Rating	BBB+/Stable/A-2
Certificate Of Deposit	BBB+/A-2

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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